(16)

United States of America
IN THE
Supreme Court of the United States

OCTOBER TERM, 1944

No. 1323 94

LOUIS HAMBURGER and SAMUEL HAMBURGER,
Petitioners,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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LOUIS HAMBURGER and SAMUEL HAMBURGER,
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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

To the Honorable, The Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your Petitioners, Louis Hamburger and Samuel Hamburger, respectfully represent that:

SUMMARY STATEMENT OF THE MATTERS INVOLVED

This case involves a substantive question of income tax law, the application by the lower court of the doctrine of *Helvering v. Clifford,* 309 U. S. 331, holding that the income of a short term trust with a reversion to the grantor, who was himself trustee with elaborate powers, was taxable to the grantor under Section 22 (a) I. R. C. to the trusts in the instant case where none of the decisive elements of the Clifford case were present.

In the trusts at bar there was a complete transfer of title to the trustee who was not the settlor; the term was as long as the law permitted, to-wit, the survivor of two lives in being; there was no reversion whatsoever to the settlor; the trusts were irrevocable and unalterable; the settlor was expressly excluded from any benefit directly or indirectly in corpus or income; the trustee's powers of control were powers in trust and expressly stated to be exercisable only for the benefit of the trust; the settlor retained no substantial property so that it could not be said that the settlors did not feel the poorer after the transaction. The trusts provided for discretionary accumulation during the lifetime of the settlor but provided for minimum income and corpus distribution thereafter. The trusts also reserved to the settlor the power to change the beneficiaries (which power was never exercised) subject to the limitation of the instrument excluding the settlor from benefitting thereby directly or indirectly and the trusts were created by each petitioner naming his brother as trustee simultaneously with similar action by the other brother. It is apparently on the basis of these two last named factors that the Court below held the income taxable to the settlors.

The taxes involved in the years in question amount to over $73,000.00. If the decision below is applied to later years up to the present date, the deficiency would total approximately $500,000.00, a sum greatly in excess of the total income of the petitioners for the corresponding periods.

STATEMENT OF THE CASE

The facts are undisputed. The Petitioners are brothers, citizens of the United States and residents of Detroit, Michigan. They went into the waste material business together some 18 years ago, first as co-partners, then as equal shareholders of H. B. Hamburger nad Company, a Michigan corporation (R. 57). In December, 1937, the Petitioners created the trusts here involved (R. 57).

The trusts were for the benefit of their respective wives and children with a separate trust for the benefit of each beneficiary. Samuel created two trusts for his wife and one child and Louis created five trusts for his wife and four children (R. 58-62). Each transferred all of his capital stock in the corporation to the trusts equally divided among the trusts (R. 61). The stock constituted all of their property other than their homes which they owned jointly with their wives and about $45,000.00 of life insurance which was not paid-up and required the payment of premiums (R. 61). Each trust contained identical terms varying only in the name of the primary beneficiary (R. 105).

On November 3, 1938, another trust was created by Samuel for his child, Sola Jane, who was born after the original trusts were created (R. 57). This was pursuant to a provision common to all the trust agreements that any

after-born child should become a beneficiary on an equal basis (R. 110).

Each trust created by Samuel named Louis as trustee (R. 106) and each trust created by Louis named Samuel as trustee (R. 58, 59). The term of each trust is for the life of the survivor of Samuel Hamburger and Louis Hamburger. The income is to be paid to the named beneficiary or in the discretion of the trustee accumulated, but with minimum guaranteed distributions after Settlor's death. There is an express prohibition against payment for support. There is no reversion (R. 106-112). The discretion of the trustee has been exercised in favor of accumulation (R. 78).

Power is reserved to the settlor to change the beneficiary, add a beneficiary or increase or decrease the beneficiary's interest. The settlor is expressly forbidden to name himself or his estate as beneficiary (R. 111). This power is subject to the limitations contained in the trust agreement, among which is paragraph 10 which provides as follows:

> "That the said Settlor or his estate shall not directly or indirectly become vested or revested with any legal or beneficial interest in the trust property or its proceeds, either of income or principal, nor shall any income, principal, or interest, beneficial or legal, in the trust property be held or accumulated for future distribution to the Settlor or to his estate, nor shall the same be distributed to Settlor or to his estate, nor shall any part of the principal, income, or proceeds of the trust property, or any part thereof, ever be applied to the payment of premiums upon policies of insurance upon the life of the Settlor, nor be used or applied for the support of the Settlor or for the benefit of Settlor or his estate, nor used to satisfy any obligation of the Settlor or his estate" (R. 111).

And paragraph 14 which provides as follows:

> "This trust is hereby declared to be irrevocable and there shall be no power to terminate, alter, or amend this trust instrument, nor shall there be any power on the part of anyone to revest in the Settlor or his estate any part of the corpus of the trust" (R. 112).

Powers of investment not limited to legal trust investments and power of control and management were vested in the trustee but in trust and for the benefit of the trust "with a view to create the greatest income therefrom, and to increase the value of the trust property to the best of the Trustee's ability" (R. 108).

There is a spendthrift clause (R. 110) and also a provision that a minimum amount of not less than $50.00 per month nor less than 50% of the Trustee's compensation nor less than 50% of the net monthly income shall be paid to the beneficiary after the Settlor's death (R. 109). Upon termination of the trust, the property, principal, income and any accumulations is distributable to the then beneficiary (R. 112). The purpose of creating the trust was to accumulate money for the wife and children of the Settlor and protect the business in case of the death of either of them and to make provision for subsistence of the family of each Settlor after his death (R. 64, 67).

In December of 1938, the corporation was dissolved. From the formation of the trusts on December 27, 1937 until the dissolution of the corporation on December 30, 1938, Louis continued to be President of the corporation and Samuel continued to be Secretary-Treasurer and each received a salary, which before minor deductions, was $17,500.00 (R. 70-72).

Upon the liquidation of the corporation, all the property was conveyed to the trusts (R. 62) who elected to be taxed

upon the gain under Section 112 (b) 7 of the Revenue Act of 1938 (R. 17). This gain was in the amount of $103,-522.17 (R. 55) and was included in the return of the trusts which duly paid their tax thereon. Such gain is likewise included in the amount of income assessed against the petitioners herein (R. 97). On December 27, 1938, Samuel, individually and as trustee under the several trusts, and Louis, individually and as trustee under the several trusts, entered into a written partnership agreement effective after December 30, 1938 (R. 113-118). This agreement provided that the parties become and remain partners in the business of dealing with waste and steel products (R. 113). The capital was to consist of the assets received in the liquidation of the corporation (R. 113, 114). All of the capital was furnished by the trusts which had received all of the assets of the corporation (R. 114). The partnership was to be managed by Louis and Samuel Hamburger who were to receive 15% each of the net profits as compensation for their services (R. 115), the remaining 70% of the profits to be divided between the trusts in proportion to the interests transferred to the partnership (R. 115, 116). On liquidation, Samuel and Louis would receive no part of the capital of the partnership (R. 113-118).

This partnership has continued to operate the business since December, 1938 (R. 62). Samuel and Louis have each been receiving 15% of the net income (R. 62). They have no other income (R. 61). They have continued to conduct the business as managing partners (R. 70).

Petitioners have continued to support their wives and children from their portion of the net profits of the partnership (R. 78). The income of the trusts has been accumulated and invested in United States Government Bonds to the amount of $100,000.00 (R. 77). No change of beneficiaries has occurred (R. 63) other than the admission of

the after-born daughter of Samuel pursuant to the terms of paragraph 7 of the trust agreement (R. 57, 110).

The trusts have duly reported and paid tax upon dividends received from the corporation, the capital gain on liquidation and the 70% of the net earnings of the partnership. Petitioners have duly reported and paid tax on their salaries from the corporation and their portion of the net profits of the partnership.

One of the Petitioners at one time borrowed from $15,000 to $18,000 from the trusts (R. 63). There is no proof or claim that the other petitioner did so. The circumstances of this transaction will be discussed within.

The Commissioner issued his 90-day letter to each Petitioner May 25, 1942 for the years 1937-1940 inclusive asserting the deficiencies totaling $36,626.15 (R. 15) in the case of Louis and $37,615.78 (R. 36) in the case of Samuel. The Petitioners on August 21, 1942 filed their petitions for redetermination of the alleged deficiencies with the Tax Court of the United States (R. 5, 25). The cases were consolidated for hearing and decision and were tried before the Tax Court of the United States at a circuit hearing in Detroit, Michigan on September 28, 1943 and Judge Sternhagen presided (R. 3). His opinion and findings of fact were promulgated December 24, 1943 in the form of a memorandum opinion (R. 87-97) and hence not reported.

Petitioners' motion for review by the entire Tax Court was denied (R. 4). On February 14, 1944, a decision of the Tax Court was entered in favor of the Commissioner and against taxpayers, holding Louis Hamburger liable for deficiencies aggregating $36,113.10 and Samuel Hamburger $37,102.74 (R. 98, 99).

Taxpayers on May 1, 1944 filed their petition for review by the United States Circuit Court of Appeals for the Sixth Circuit (R. 99). By stipulation approved by the Circuit Court of Appeals the two cases were consolidated for hearing and decision under a single record (R. 105). The cause was argued and submitted on February 12, 1945 and judgment was entered March 12, 1945 affirming the decisions of the Tax Court on the grounds and for the reasons set forth in the opinion of the Tax Court. The order of the Circuit Court of Appeals is reported in 147 Fed. (2d) 856. No opinion was rendered by the Circuit Court of Appeals. The findings of fact and opinion of the Tax Court may be found on pages 87-97 of the record.

THIS PETITION PRESENTS THREE QUESTIONS

I.

After the creation of the trusts did the Petitioners retain such rights as to be still the owners of the property transferred within the meaning of Section 22 (a) of the Internal Revenue Code so that the income from such property remained taxable to the Petitioners?

The Tax Court and the Circuit Court of Appeals both determined that the Petitioners remained the owners of the trust property and were taxable on the income therefrom.

II.

Under Section 181-182 of the Internal Revenue Code, may Petitioners be taxed for the share of partnership income belonging to the other partners pursuant to a written partnership agreement?

The Tax Court and the Circuit Court of Appeals both held that the petitioners were taxable on all of the partnership income.

III.

Is ownership of trust property for tax purposes where the facts are undisputed and evidenced by written agreements a question of law within the scope of review by the Appellate Courts on appeal from the Tax Court?

The Circuit Court of Appeals held that it was not reviewable. The Tax Court, of course, did not pass upon this question.

BASIS OF JURISDICTION

Jurisdiction is invoked under 28 U. S. C. 347.

Petitioners are advised and believe that the judgment of the Circuit Court of Appeals is erroneous and contrary to the just rights of Petitioners, and that this Court should require said cause to be certified to this Court for its review and determination in conformity with the provisions of the Acts of Congress in such case made and provided.

REASONS FOR GRANTING PETITION

Certiorari should be granted for the following reasons:

1. The decision of the Circuit Court of Appeals is in conflict with a decision of another Circuit Court of Appeals on the same matter, *i.e.*, the decision of the 10th Circuit in the case of *Armstrong v. Commissioner*, 143 F (2d)

700 C.C.A. 10 and with the decision of the 1st Circuit in *Commissioner v. Branch,* 114 F (2d) 985 and with the decision of the 7th Circuit in *Commissioner v. Betts,* 123 F (2d) 534. In each of these cases, although the circumstances were more closely within the framework of *Helvering v. Clifford,* 309 U. S. 331 than in the case at bar, the several circuits held that the income from the trusts there involved was not taxable to the grantors whereas the 6th Circuit in the instant case held that it was.

2. The Court below has decided a federal question in a way probably in conflict with applicable decisions of this Court in that this Court in *Helvering v. Stuart,* 317 U. S. 154 decided that the power to change beneficiaries (to one other than the grantor) and the fact that the trusts involved were reciprocal did not require the taxation of the income therefrom to the grantors. The decision below taxes the income of the trust in this case to the grantors primarily because of the existence of these two factors.

3. The Court below has decided an important question of local law in a way probably in conflict with applicable local decisions in that it has decided that the powers of the trustees could be employed for their own benefit although this holding is directly in conflict with the terms of the trust instruments themselves and with the decisions of the Supreme Court of Michigan which hold that powers of a trustee are powers in trust and must be exercised for the benefit of the trust and that he can take no benefit or advantage of them for himself. *In re Culhane's Estate,* 269 Mich. 68.

4. The decision below has decided another federal question in a way probably in conflict with applicable decisions of this Court in failing to give proper significance

to the fact that the power to change beneficiaries was unexercised thus conflicting with the decision of this Court in the analogous field of the estate tax in *Helvering v. Safe Deposit and Trust Company,* 316 U. S. 56 where this Court held that when a power of appointment was unexercised the property subject thereto was not taxable in the estate of the donee under *Section 302 (a) Revenue Act of 1926* (Section 811 I. R. C.) which is the general gross estate provision corresponding to *Section 22 (a) I. R. C.* for the income tax.

5. The decision of the Circuit Court of Appeals is in conflict with the decision of other Circuit Courts of Appeals on the same matter, *i.e.,* the decision of the 10th Circuit in *Armstrong v. Commissioner,* 143 F (2d) 700 and of the 5th Circuit in *Montgomery v. Thomas,* 146 F (2d) 76. Those Courts held that partnerships must be taxed in accordance with the provisions of *Section 181 et seq. I. R. C.* and that the control factors which exist in partners are the accompaniment of a fiduciary relationship and necessarily incident to all partnerships and must be employed for the purpose of advancing the interest of the business and do not serve to bring into play *Section 22 (a) I. R. C.* The decision of the Court below is directly to the contrary. In the *Armstrong v. Commissioner* case the conflict was even more marked because the partnership was between settlor and his trust exactly as in the case at bar.

6. The Court below has rendered a decision in conflict with the decision of another Circuit Court of Appeals in the same matter in that it is has held that when, as here, the facts are undisputed the ownership of trust property was, rather than a question of local law, a question of fact peculiarly within the competence of the administrative tribunal, the Tax Court, a misapplication of the decision of this Court in *Dobson v. Commissioner,* 320 U. S. 489.

This error was expressly avoided by the 10th Circuit in its decision in *Armstrong v. Commissioner,* 143 F (2d) 700 which held that the question of ownership of trust property was purely one of law which it was the duty of the Circuit Court of Appeals to resolve upon appeal rather than to permit the decision of the Tax Court in such a field of local property law which is outside of its special competency to stand without judicial inquiry or challenge despite its being fraught with error.

7. The Court below has decided a federal question in a way probably in conflict with applicable decisions of this Court in determining that when the facts are undisputed, the ownership of trust property was, rather than a question of local law, a question of fact peculiarly within the competence of the administrative tribunal, the Tax Court, a misapplication of *Dobson v. Commissioner,* 320 U. S. 489. This misapplication of the *Dobson v. Commissioner* case is in conflict with the decision of this court in *Helvering v. Stuart,* 317 U. S. 154 where this court held that the determination of the Circuit Court of Appeals on the question of local law of the nature and ownership of the trust property was to be adopted and preferred, to the decision of the Tax Court on such a subject, thus clearly demonstrating that the jurisdictional limitations of the Dobson case can have no application to this situation.

It is submitted that these are vital questions of tax administration of great importance to taxpayers, the Bar and the administrative officers of the Government and therefore constitutes a question of general and public importance which only this Court can resolve.

Wherefore, Petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Ap-

peals for the Sixth Circuit, to the end that said cause may be reviewed and determined by this Court, as provided by law, and that Petitioners may have such other and further relief or remedy in the premises as to this Court may seem appropriate, and that the judgment of said Circuit Court of Appeals may be reversed by this Honorable Court.

LOUIS HAMBURGER and
SAMUEL HAMBURGER,
Petitioners,

By EDWARD S. REID, JR.,
And HAROLD M. SHAPERO,
Attorneys for Petitioners.

United States of America

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No.........................

LOUIS HAMBURGER and SAMUEL HAMBURGER,
Petitioners,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

I.

OPINION BELOW

The Circuit Court of Appeals did not render an opinion in this case. The order of the Court is reported at 147 F (2d) 856.

The findings of fact and opinion of the Tax Court were in memorandum form, unreported. They may be found at pages 87-97 of the record.

II.

JURISDICTION

Certiorari is prayed and jurisdiction is invoked under 28 U. S. C. 347.

III.

QUESTIONS INVOLVED

1. After the creation of the trusts did the Petitioners retain such rights as to be the equivalent of ownership of the property transferred within the meaning of Section 22 (a) of the Internal Revenue Code so that the income from such property remained taxable to the Petitioners?

2. Under Section 181-183 of the Internal Revenue Code, may Petitioners be taxed for the share of partnership income belonging pursuant to a written partnership agreement to the other partners?

3. Is ownership of trust property where the facts are undisputed a question of law within the scope of review by the Appellate Courts on appeal from the Tax Court?

IV.

ASSIGNMENTS OF ERROR

1. The Circuit Court of Appeals erred in affirming the decisions of the Tax Court.

2. The Circuit Court of Appeals erred in failing to make an independent determination of the questions of law of ownership of the trust property.

3. The Circuit Court of Appeals erred in holding the income of the trusts taxable to Petitioners under Section 22 (a) I. R. C.

4. The Circuit Court of Appeals erred in failing to tax the income of the partnership in accordance with the provisions of Sections 181 to 183 I. R. C.

5. The Circuit Court of Appeals erred in holding that the income of the trusts was taxable to Petitioners under *Helvering v. Clifford*, 309 U. S. 331.

6. The Circuit Court of Appeals erred in holding that the income of the trusts was taxable to Petitioners because the Settlors reserved power to change the beneficiaries.

7. The Circuit Court of Appeals erred in holding that the income of the trusts was taxable to Petitioners because the trusts were concurrent.

8. The Circuit Court of Appeals erred in holding that the income of the trusts was taxable to Petitioners because of control factors when such elements were incidental to the partnership relationship.

9. The Circuit Court of Appeals erred in denying legal effect for tax purposes to the actual, existing and operating partnership.

10. The Circuit Court of Appeals erred in taxing to Petitioners the capital gain on liquidation of the corporation which was an increment to the trusts only.

11. The Circuit Court of Appeals erred in failing to recognize that powers of the trustees and of the settlors were powers in trust for the benefit of the trusts only.

12. The Circuit Court of Appeals erred in holding that the income of the trusts was taxable to Petitioners because one of the Petitioners had at some time borrowed from the trusts.

13. The Circuit Court of Appeals erred in failing to hold that an unexercised power in settlor to change beneficiaries does not cause the income from the trusts to be taxable to Petitioners.

14. The Circuit Court of Appeals erred in failing to consider local rules of property and trust administration regarding the legal effect of the terms of the trusts and powers of the trustees and settlors.

V.

ARGUMENT

A.

THE SETTLORS HEREIN DID NOT REMAIN THE OWNERS OF THE TRUST PROPERTY AND ARE NOT TAXABLE ON THE INCOME THEREFROM UNDER SECTION 22 (a) I. R. C. AND HELVERING v. CLIFFORD, 309 U. S. 331

1. *Complete Transfer of Title:*

The title to the trust *res* was completely transferred to the Trusts carrying with it the right of the trusts to the income. The Settlors retained neither title nor income of the trust *res.*

2. *Length of Trusts:*

These trusts are not term trusts. They extend even beyond the life of the settlor, and such extension was a material inducement in the creation of the trusts, as the grantor desires to provide a minimum income for the beneficiaries of his trusts during that period of need which would follow the settlor's death, with its consequent removal of the support which he had, during his lifetime been rendering to them out of the compensation he received for his services to his business.

The trust period is the longest period for which, under the applicable Michigan Statutes governing perpetuities and restraints on alienation, real property can be retained in trust, that is, a period measured by two lives in being at the time of the creation of the trust, Section 12935, Compiled Laws of Michigan, 1929. Upon the expiration of this period, the trust property was required to be transferred by the Trustee to the beneficiary and could not pass to the settlor or his estate.

3. *No Reversion to Settlors.*

The settlors retained no reversionary rights, possibility of reverter or any other interest upon termination of the trust. While the trust continued, it was specifically provided that none of the income or *corpus* of the trust should be used to satisfy any obligation of the settlor or for the support, maintenance or education of the wife or child of the settlor, nor distributed to the settlor or his estate directly or indirectly (R. 111).

4. *Settlors Retained No Substantial Property.*

The settlor did not retain any substantial amount of property after each created the trusts. Each grantor parted with substantially all of his property. That which he retained; his home, insurance in modest amount, carrying the liability of periodic premium payments, was property of a sort over which the settlor's ownership was limited, either being joint as in case of the homestead, or property in which he would never benefit, as the insurance, which was actually coupled with a liability with respect to which the settlor would probably obtain no benefits, and which had continued burdens of liability. Neither was the class of property which gives economic satisfactions of control, and neither was income-producing property which could result in economic benefits.

5. *Economic Necessity Dictated Choice of Trustee.*

The trust property consisted of shares of stock in a corporation engaged in the waste material business which business had been started by Louis Hamburger and Samuel Hamburger as co-partners in 1926 and had been managed by them ever since. If a complete stranger had been named as Trustee, economic necessity would have required that such stranger employ Samuel Hamburger and Louis Ham-

burger as the managers of the trust estate. Control and power over the trust estate in Louis and Samuel Hamburger was, therefore, incidental, and inherent in the nature of the property itself. In all probability, it would have existed by necessity even though not expressly provided for by the trust agreements.

6. *Powers of Control in Trustee Were Only Powers in Trust.*

The control given to the Trustee in the trust instrument was expressly restricted in that such control should be exercised for the purpose of creating the greatest income from the trust estate and increasing the value of the trust property (R. 108). The trust agreement contained no exculpatory clauses in favor of the Trustee which are common in trust agreements.

7. *Provisions Excluding Settlor From Any Benefit Specific, Definite and Extensive.*

The trust instrument expressly, extensively and directly prohibited the settlor or his estate from directly or indirectly benefitting from the trust, such provision being:

> "10. That the said Settlor or his estate shall not directly or indirectly become vested or revested with any legal or beneficial interest in the trust property or its proceeds, either of income or principal, nor shall any income, principal, or interest, beneficial or legal, in the trust property be held or accumulated for future distribution to the Settlor or to his estate, nor shall the same be distributed to Settlor or to his estate, nor shall any part of the principal, income, or proceeds of the trust property, or any part thereof, ever be applied to the payment

> of premiums upon policies of insurance upon the life of the Settlor, nor be used or applied for the support of the Settlor or for the benefit of Settlor or his estate, nor used to satisfy any obligation of the Settlor or his estate."

The right of the settlor to change the beneficiary was likewise limited in that "the settlor shall have no power to name himself or his estate as beneficiary hereunder" (R. 111). Moreover, in paragraph 14 it is expressly provided: "nor shall there be any power on the part of anyone to revest in the Settlor or his estate any part of the corpus of the trust" (R. 112).

8. *The Trust Is Irrevocable and Unalterable.*

The declaration of trust expressly provides that it is "irrevocable and there shall be no power to terminate, alter or amend this trust instrument" (R. 111).

9. *Trustee Compensation Must Be Reasonable.*

The trust instrument specifically limited the Trustee to only reasonable compensation for his services as Trustee under paragraph 5 (R. 109). Under no circumstances can Trustee or his estate receive anything out of the trust estate except reasonable compensation for services performed.

10. *Trustees Required To Give Detailed Annual Accountings.*

The Trust instrument (Par. 6) requires the Trustee to annually furnish itemized account showing receipts, disbursements, sales, exchanges, compensation retained by Trustees and all other important financial transactions to the beneficiary (R. 109, 110).

11. *Unexercised Power of Settlor to Change Beneficiaries Prohibited Settlor or His Estate From Benefitting Thereby, Would Be Exercised, if at all, Only to Change Shares of Children.*

The power of Settlor to change beneficiaries provided for in Paragraph 9 expressly limited such power to naming persons other than the Settlor. It contained an express provision that the Settlor should have no power to name himself or his estate as beneficiary (R. 111). It provided that Settlor or his estate shall not directly or indirectly become vested with any legal or beneficial interest in the Trust Res or in any accumulations. It prohibited use of Trust Res to purchase insurance policies on the life of the Settlor or to pay any obligations of the Settlor or for the support of Settlor (R. 111). It further provided that none of the moneys paid to the beneficiaries shall be used for the support or maintenance of the wife or child of Settlor nor for the support of any person whom the Settlor has any obligation to support or maintain, paragraph 4 (R. 109). The trust was irrevocable, paragraph 14 (R. 112).

The power to change beneficiaries was never exercised at any time (R. 63). None of the Trust income was used for the support of wife or children (R. 78). Settlors retained practically no property (R. 61). The Trusts were entitled in the name of the wife and the children, provided for the minimum payments after death of the Settlor, contained spendthrift provisions, all of which indicated that if the power was exercised at all, it would be exercised only to change the shares. The purpose of creating the Trusts was to protect the Settlor's families (R. 64-66).

The effect of the power of the Settlor to change beneficiaries as to taxability of Settlor on the income earned by the Trusts will be later discussed at length. It suffices at this point to point out the above circumstances and the

fact that the contest here is as to whether the Settlor or the Trusts were the owners within the meaning of Section 22(a), and that whoever the beneficiaries were is of no consequence so far as the Trusts were concerned. The Trusts would remain the owners, irrespective of who the beneficiaries were which would be of importance only in the event a contest should arise between the Trusts and the beneficiaries as to who, as between them, would be the owner, under Section 22a.

12. *Power To Accumulate.*

The power to accumulate in the Trusts was retained by Settlor, but under the Trust instrument none of such accumulations could ever be used for the benefit of the Settlor, his estate, or to pay the Settlor's obligations. Minimum payments to beneficiaries after Settlor's death was required.

This Court is, of course, completely cognizant of the principle and rationale of its decision in the Clifford case, and is also aware of the confusion and conflict in the application of it by the lower courts to varying fact situations. We will not burden the Court with a repetition of the analysis of that decision other than to point out that not one of the three elements of reversion, short term and control apply to the trusts in this case. The purported application of the decision to these trusts is founded entirely upon extensions of the decision by the lower courts to other situations and combinations of factors

If the Clifford case applies here, it is because it is far more far reaching than its decision and than this Court has held in any subsequent case. It must be because the lower court construes the Clifford case rule as taxing income to the settlors from long term trusts and income

from trusts with an unexercised power to change beneficiaries to persons other than the settlor. The Clifford decision did not so hold. The language and ratio *decidendi* of that case does not say so or even so imply. The only subsequent decision of this court on the subject, *Helvering v. Stuart*, 317 U. S. 154, indicates to the contrary for the trusts there involved were concurrent and there was power to change the beneficiaries, yet the only Stuart trusts whose income was held taxable to the grantor were those for support.

We must therefore turn to the underlying philosophy of the Clifford case and consider its applicability. First, it must be remembered that Congress has established a system for taxing the income from trusts which is definite in recognizing the separate taxability of trusts as entities. Sec. 161-165, I. R. C. Congress has also specifically provided for the taxation to the grantor of income from trusts where he can recapture the corpus (Sec. 166 I. R. C.) and obtain the income or its immediate use (Sec. 167 I. R. C.). Therefore any reallocation of income by a court decision not in accordance with the framework of this fairly complete statutory scheme requires strong reasons. This Court found such reasons in the Clifford situation to bring into play the wide sweep of Sec. 22 (a) I. R. C., a decision with which there can be no quarrel since it is obvious that a short term trust with a reversion approaches revocability in practical effect, particularly when coupled with extensive control factors.

The situations specified in Sec. 167 where the grantor remains taxable on the income are cases where the grantor obtains or may obtain the income *immediately*, or applies or may apply it to the satisfaction of an obligation measurable in money. Should courts create new subdivisions of that section to apply its rule to intangible, remote, in-

direct and moral satisfactions not measurable in money? Congress has not seen fit to do so, and it is peculiarly within the province of the legislative body. It must not be forgotten that these settlors have permanently parted with title to the property and use of the income. They have created a legal situation which is irrevocable and which deprives them completely and forever of the corpus and income. The decision below taxes them on income they can never obtain actually or for use. The tax on the trust income plus their own income is more than the income they can command to pay the tax. That fact alone is proof that Congress could not have intended such an unjust impasse. In all the situations of Sec. 167, the settlor either receives the income or applies it to his use so that he may fairly be chargeable with tax on it—in effect or actually he may use it or its equivalent to pay his tax. Here the settlor has no possibility of obtaining the income or using it and can not possibly use it to pay his tax.

1. Power to Change Beneficiaries

It would be fruitless to analyze the myriad of decisions under the Clifford case. The circumstances vary infinitely. The inevitable conclusion to be drawn is that the lower courts have in one situation or another, while stressing unduly one of the three factors, taxed the income to the grantor when the term was long or when there was no reversion or when only control factors existed, although this Court's decision required the existence of all three factors. In addition, the lower courts have taxed the income to the settlor when none of the factors of the Clifford case were present, thus creating some new factors of their own, and invading the province of Congress. An example of this is *Commissioner v. Buck,* 120 F. (2d) 775 (CCA 2), and *Brown v. Commissioner,* 131 F. (2d) 640

(CCA 3). The Buck case was a situation where the grantor having retained the power to change beneficiaries, retained very substantial property outside of the trust, and the wife beneficiary employed the trust income to pay premiums on policies insuring the grantor's life. The trust term was short. In the Brown case, the power of change was exercised, and there was a reversion. In neither of these cases was there present the terms of the trusts of this case that change of beneficiaries would be only a shifting among the existing beneficiaries. This is clear from the after-born children clause, the spendthrift clause and the minimum payment clause. The Buck case has been somewhat curtailed by a later decision in the same circuit—*Phipps v. Commissioner*, 137 F. (2d) 141 (CCA 2).

This Court has not considered the power to change beneficiaries to be decisive for taxation because that power existed in *Helvering v. Stuart*, 317 U. S. 154, and the only trusts held taxable to the grantor were for support. Furthermore, in *Helvering v. Safe Deposit and Trust Co.*, 316 U. S. 56, this Court held that an unexercised power of appointment was not taxable under Sec. 811, I. R. C., the general gross estate clause similar to Sec. 22 (a) I. R. C. governing gross income. This Court therefore recognized the significance of the non-exercise of a power and would logically decline to bring a trust with an unexercised power to change beneficiaries under Sec. 22 (a) I. R. C. Congress by the 1942 Act amended the Internal Revenue Code to make property passing under an unexercised power of appointment includible in the gross estate. Sec. 811 (f) I. R. C. It is to be noted that certain powers were exempted —to appoint to descendants, spouse, etc., and that a period of grace was given, and successively extended, during which the powers could be released tax free. (Sec. 403 (d) Revenue Act of 1942). Thus this Court properly left the taxa-

tion of unexercised powers to Congress, and Congress exercised its power to tax with restraint, granting certain exemptions, and it avoided the inequity of application to existing instruments by giving the period of grace for tax free release. And by Section 826 (d) I. R. C. the estate may recoup the tax so paid from the beneficiaries while here the settlor must pay the tax without any right of reimbursement. It is respectfully submitted that in the income tax field also the imposition of a tax should be left to Congress, which would apparently give relief against the retroactivity which is so harsh in the situation at bar where the trusts were created before the Clifford decision and all the subsequent elaborations of it.

It may also be observed that the power to change beneficiaries is not a right to corpus under Sec. 166 or immediate right to income or its use for discharge of obligations under Sec. 167. It is a satisfaction which is not measurable in money, and not within the statutory framework. That Congress is not indifferent to its province in specifying taxable incidents under Sec. 167 is apparent from the amendment made by Sec. 134 (a) of the Revenue Act of 1943 (Sec. 167 (c) I. R. C.) passed after the decision in *Helvering v. Stuart,* 317 U. S. 154, which limits the taxability of income from trusts for support to that actually employed for maintenance.

Great weight should be given to the article on this subject by Roswell Magill, former Under Secretary of the Treasury. In "What Shall We Do With the Clifford Case," April, 1945 Taxes, p. 290, 299, he takes the position that the power to change beneficiaries does not justify taxing the income to the settlor, stating it as follows:

> "The case of power to shift income among beneficiaries or to change beneficiaries has the same statutory background. Congress did not cover this

type of trust in Section 166, and it did exercise its legislative powers specifically in similar situations. Granted that the possession of these powers gives the settlor an important form of control, Congress apparently did not think them great enough to justify taxing the settlor on the income. Obviously he cannot by the use of his powers obtain the money to pay the tax; nor can he get the property back."

2. Concurrent Trusts

Each of the petitioners made his brother the trustee of his trusts. The Tax Court concluded from this that the control situation was the same as though each had continued to be the owner of the property transferred. This doctrine is not founded upon any court decision. The only case cited by the respondent in his brief in the Circuit Court was "Cf. *Lehman v. Commissioner,* 109 F. (2d) 99," an estate tax case where reciprocal powers to withdraw resulted in a taxable transfer of the amount subject to withdrawal—and there each settlor created a trust for his brother and his brother's children, not for his own children, as here. That case involves reciprocity of beneficiaries and powers of withdrawal—our case involves only reciprocity of the powers of trustees. It is possible to assert that a right to withdraw from A's trust is equivalent to a retention of that amount from B's own trust, when B dies. But it is not possible to assert that A's powers as trustee of B's trust are equivalent to his having retained such powers as settlor of his own trust, when he actually has no such powers over the property he has transferred, and he must use his powers as trustee of his brother's trust for the benefit of the trust, both expressly by the terms of the instrument and as a matter of local law of trusts. To apply the reciprocal theory here is to assume more than a breach of trust, it is to assume that the two brothers will

join in a conspiracy in breach of trust, a disloyalty both to his own and his brother's children, in abrogation of the very trusts they have just carefully created.

This Court has answered this question in *Helvering v. Stuart,* 317 U. S. 154, where concurrent trusts existed, but that feature was given no tax significance whatsoever.

It is important to note that all powers of control and management are in petitioners each as trustee of the brother's trust, not as settlor (except the power to change beneficiaries, discussed above) and hence any claim of applicability of control doctrines of the Clifford case and the cases which purport to follow it erroneously assumes the reciprocal trusts theory is effective.

Even if the settlors were trustees of their own trusts, it is now recognized that they hold those powers in trust and can not use them for their individual benefit, *Armstrong v. Commissioner* 143 F. (2d) 700, and *Lowenstein Estate v. Commissioner,* 3 T. C. 1133 and hence have no tax significance. Moreover the trust instruments here expressly so provide.

3. Power to Borrow

The Tax Court apparently attached considerable importance to the fact that one petitioner borrowed from the trusts. It does not appear when this occurred, or whether it occurred in any of the years involved or that the amount exceeded the credits due the petitioner under the partnership agreement, or that the other petitioner ever borrowed. The prohibition against settlor benefitting from the trust precludes authority to borrow, but if there was any such authority loans would have to be on ample security and at fair interest. *Philip Meyers v. Commissioner,* Tax Court

Memorandum Opinion, May 17, 1944 (CCH Decision 13941 M).

B.

THE PARTNERSHIP MUST BE TAXED UNDER SECTIONS 181-183 I. R. C.

Not only has the respondent, the Tax Court and the Circuit Court ignored the trusts as legal entities, but they have also refused to recognize the partnership and the scheme of taxation established by Congress for partnerships. The family partnership situation is a favorite subject of litigation at the present time. This Court has not yet decided any case where the existence of a partnership has been ignored for tax purposes. It would unduly prolong this brief to analyze the numerous cases. It can be stated that the fortunes of the respondent have varied in this type of litigation, but a generalization can be made that the partnerships have been denied recognition where there is in effect a mere attempt to assign income, where the business is a personal service enterprise with the wives or children making no contribution, where capital is not a factor in the business, or where no *bona fide* partnership is created.

In the instant case, capital is a prominent factor in the business, and all of the capital was furnished by the trust partners. There is no doubt whatsoever that the partnership is a going business with legal and actual existence. A number of cases have recognized the validity for tax purposes of partnerships between settlors and their trusts. Perhaps the leading case is *Commissioner v. Armstrong,* 143 F. (2d) 700 where it is pointed out that the control factors were a concomitant of the partnership relationship. It is to be noted that the trust joining the

partnership gave the taxpayer there majority control of the partnership, while in our case, control of the partnership was equal, so that neither petitioner was in control. Yet the trust income and the partnership income of the trust was not taxable to the settlor. *Hardymon v. Glenn*, 56 Fed. Supp. 269 (W. D. Ken.), specifically holds that I.R.C. 181 and 182 applies to partnerships and that the statutory provisions can not be overcome by the general principles of the Clifford case, even if minimizing or avoiding taxes was the motive for creating the partnership. The Tax Court has taken this stand in *Robert P. Scherer*, 3 T. C. 795, not appealed by the government, where the partners in a highly technical business were the husband and his wife individually and as trustee for minor children. Sec. 181 I. R. C. was applied over the government's claim that *Helvering v. Clifford* called for the application of Sec. 22 (a).

Similarly, *Wachovia Bank & Trust Company v. Commissioner*, Tax Court Memorandum Opinion, June 22, 1944, CCH Decision 14001 (M) The same view is taken in *Montgomery v. Thomas*, 146 F. (2d) 76, (C.C.A. 5), where a partnership between a father and minor sons was recognized and the income taxable to the partners under Sec. 181 I.R.C. and not to the father under Sec. 22 (a) I.R.C. Also the purpose of minimizing or avoiding taxes was held immaterial, and a large loan to the father from the children was recognized by the allowance of an interest deduction, with no effect upon the application of Sec. 181.

The Sixth Circuit has itself upheld the validity of a husband and wife partnership in a very recent decision *Tower v. Commissioner*, April 2, 1945, 45—1 U.S.T.C. Par. 9246. There, as here with the trusts, the wife received stock in a corporation, which was dissolved and a partnership formed. She rendered no services to the

partnership and her receipt of the corporate assets was conditioned upon contribution to the partnership, and the husband alone conducted the business. The business involved was somewhat similar to that in the case at bar—it was an iron works. The Tax Court was reversed.

The conclusion is inevitable that the partnership here involved must be recognized and taxed under Sec. 181 *et seq.* I.R.C. because of its commercial reality, which prevents Sec. 22 (a) applying, and because the Clifford doctrine does not apply to partnerships where family trusts are partners, according to numerous decisions of the Tax Court and Circuit Courts of Appeals. It is respectfully suggested that there is complete merit to that view since the control, short term, and reversion factors of family trusts, which are private and intimate may indeed give an economic equivalent of ownership warranting application of Sec. 22 (a) while a business enterprise which deals with the world at large, is semi-public in its nature and subject to the exigencies of the commercial world, makes control factors of no tax significance, particularly when they are normal concomitants of the partnership relationship and would exist in the petitioners whether the partners were family trusts or strangers.

The control is not in the nature of reservations or strings retained, it is an inevitable accompaniment of the nature of the property transferred—an interest in a business whose most beneficial administration requires the management of those who have created its success. The situation is like *Commissioner v. Betts,* 123 F. (2d) 534 (CCA 7), where the settlor's investment powers were discounted because he had experience in the security business and might therefore have thought his judgment peculiarly valuable. So here the technical competence of the petitioners as managers is necessary for the pre-

servation and accretion of the trust estates. It must not be forgotten that the managing partners are fiduciaries as partners; they can not use their partnership powers for their own benefit; while they may benefit therefrom it is only by increasing the profits of the whole and incidentally their own share of the income, on which and on which alone they are taxable.

The income of the trust-partners, the petitioners can not under any circumstances obtain for themselves, use it for their obligations or benefit, and they have no interest whatsoever in the capital of the partnership except the indirect one of economic motive of so managing it as to cause it to produce more income for the partnership as a whole. They can not benefit themselves without at the same time benefiting the trusts a great deal more with an increment the grantors can not possibly enjoy in any way. Surely such are not the economic satisfactions covered by Sec. 22 (a). A feeling of contentment over the increasing property of members of one's family is not taxable income when the taxpayer can not himself receive any benefit from the increment except the feeling itself, which is certainly of such shadowy monetary value as to be at the vanishing point.

C.

THE DOBSON CASE

This Court is well aware of the importance of its decision in *Dobson v. Commissioner*, 320 U. S. 489, and of the interest of the lower courts in its interpretation and application to tax cases as they come up for review. The problem of its application to the instant case was briefed below and was prominent in the oral argument. From the form of the order of the Circuit Court, it was apparently

the conviction of that Court that the Dobson case required affirmance of the Tax Court. We believe the Court to have erred in that respect, and we have by this judicial abdication been deprived of the independent consideration by the Appellate Court of the questions here involved.

The Dobson case reaffirms the long-standing principle, expressed in the statute itself, that the Circuit Courts may review questions of law determined by the Tax Court. The jurisdictional limitations of the case stem from this Court's holding that many so-called questions of law are actually questions of fact, and that when there are mixed questions of law and fact, the elements must be separated so as to identify a clear-cut mistake of law, else the Tax Court decision stands, and that Tax Court decisions of questions of law are entitled to great weight in a field where the administrative body has special competence.

Is it not clear that where, as here, the facts are undisputed, ownership of trust property is a pure question of law? Of course, the facts and circumstances must be found—every case necessarily presents facts—questions of law do not float in the air. But once the facts are found, their significance in determining whether the Settlor still retained ownership is a clear cut question of law. It is not a mixed question of law and fact; it is of law only. That this is so is apparent from the fact that taxpayers do not find fault with the findings, but with the legal conclusion drawn therefrom. We might have found other facts, or stressed them differently, or phrased them variously, but nevertheless, accepting every fact found as gospel truth, we point to a clear cut error of law—the petitioners do not own the trust property. Even if the question were a mixed one, the legal error can be winnowed out definitely and distinctly without carrying any fact question with it.

Nor is this Tax Court determination of the legal question one in a field in which it has peculiar competency as in the Dobson case itself where step transactions were involved (a technical tax question). Ownership of trust property is peculiarly appropriate for local determination, and peculiarly inappropriate to Tax Court decision, that body not being experienced in local law, but in the technical problems incident to taxation and accounting. The various Circuits are, after all, Appellate Courts of the states in their respective circuits and are accustomed to passing upon general common law and particular local law questions. This Court so held in *Helvering v. Stuart*, 317 U. S. 154. For simplification we have emphasized the question of law of ownership of the trust property, but there is also of equal importance the question of law of the legal existence of the partnership. In the Dobson case "The error of the court below consisted of treating as a rule of law what we think is only a question of proper tax accounting" 320 U. S. 506, 507. The questions in the instant case are not "only a question of proper tax accounting" unless all tax cases are only that, and this Court does not so hold because it specifically reserves for review questions of law in tax cases.

This Court has not yet had occasion to determine whether ownership of trust property is a question of law open to Court review within the meaning of the Dobson case. The Tenth Circuit has held specifically that it is. *Armstrong v. Commissioner*, 143 F. (2d) 700, and in a partnership-trust case. The conflict in Circuits is squarely presented by the instant case, a conflict that may only be resolved by this Court.

The later decisions of this Court which deal with the Dobson problem indicate that the Dobson jurisdictional limitations do not apply to the instant situation. In

Claridge Apartments Company v. Commissioner, 65 S. Ct. 172, the Tax Court's finding that Sec. 268 and 270 of the Chandler Act (which were revenue provisions) applied retroactively to confirmed reorganizations not finally completed was reversed by this Court, after affirmance by the Circuit Court of Appeals, on the grounds that the question "is obviously one of law, and of a sort not requiring the specialized experience of the Tax Court to determine." *Commissioner v. Lane-Wells Co.,* 321 U. S. 219, merely confirms the self-evident proposition that whether a penalty for not filing a return is to be imposed "is one of fact in the first instance for the Board's determination" 321 U. S. 225. In *Equitable Life Assurance Society of the U. S. v. Commissioner,* 321 U. S. 560, this Court could not "say on the basis of the provisions of policies and the meager stipulation that the excess interest dividends were 'interest' within the meaning of the Act as a matter of law" 321 U. S. 564. In other words, the question was one of law subject to review but the Board's decision was not in error. In *Douglas v. Commissioner,* 322 U. S. 275, this Court reviewed on the merits a question of restoration to income in the year of cancellation of a lease of depletion taken before production on minimum royalties in prior years—thus indicating that the question was one of law. In *Dixie Pine Products Co. v. Commissioner,* 320 U. S. 576 "Since the Board applied the correct rule of law, its determination that the item in question was not properly deducted on the accrual basis is entitled to the finality indicated by *Dobson v. Helvering.*" In *Security Flour Mills Co. v. Commissioner,* 321 U. S. 281 "The question is not whether the Board, within its discretion, made a determination of fact. Compare *Dobson v. Helvering,* 320 U. S. 489. It is rather whether, as a matter of law, the Board misconstrued the extent of the power conferred by the Revenue Act." The Board was reversed.

In *Commissioner v. Scottish American Inv. Co.*, 65 S. Ct. 169, the fact conclusion of the Tax Court that the taxpayer had an office or place of business in the United States was not disturbed, because the legal conclusion that followed, that the taxpayer was classified as a resident foreign corporation taxable under Sec. 231 (b) I. R. C. was inevitable, undisputed and required by the statute itself. There was no question of law—there was a command of the statute. This Court said "When the Tax Court's *factual* inferences and conclusions are determinative of compliance with statutory requirements, the Appellate Courts are limited to a determination of whether they have any substantial basis in the evidence." (Italics ours.)

In *McDonald v. Commissioner*, 65 S. Ct. 96, the determination of what constituted deductible ordinary and necessary business expense was held to be a technical tax problem as to which "we should not be inclined to displace the views of the Tax Court with our own." This Court said: "Tax language normally has an enclosed meaning or has legitimately acquired such by the authority of those specially skilled in its application. To speak of tax determination made in the system of review specially designed for federal tax cases as technical is not to imply opprobrium." In the case at bar, there is no "tax language" involved. The statute is silent on our questions of law nor is the Tax Court "specially skilled" in the property tax questions involved. Nor are the decisions of the legal questions "tax determinations"—they are erroneous decisions of local property law.

In *Commissioner v. Court Holding Co.*, 65 S. Ct. 707, "There was evidence to support the findings of the Tax Court, and its findings must therefore be accepted by the Court." This Court then proceeded to determine that

the Tax Court's determination of law based upon the facts it found was correct.

The above citations of this Court's expounding of the Dobson principle show that the pure questions of law presented by this appeal lie within the domain of judicial review. The Circuit Court is correct in reciting that there was substantial evidence to support the findings of the Tax Court, but it erred in declining to review the erroneous legal conclusions drawn from those facts and thereby deprived these taxpayers of their fundamental constitutional right to have a federal appellate court review determinations of law by an administrative tribunal.

D.

CONCLUSION

This Court is presented with square conflict between Circuits on both the trust ownership and partnership existence questions. This judicial controversy results in confusion and uncertainty which only this Court can resolve. This case also brings to this Court important questions of public moment in the application of the Clifford principles far afield from their origin—questions which affect many taxpayers and extensive property interests. This petition also raises important questions of federal administrative law in the field of taxation with respect to the scope of review by the courts of the Tax Court's decisions. It is respectfully submitted that this Court should untangle the confused snarl that conflicting lower court decisions have inflicted upon the bar and the tax paying public. While this Court undoubtedly wishes to stem the flood of tax litigation such a desirable result can be best accomplished by taking jurisdiction of an appeal such as this, decision in which will correct the

variations which now becloud the law in this field, and will make much future litigation unnecessary.

Respectfully submitted,

EDWARD S. REID, JR.,
HAROLD M. SHAPERO,
Attorneys for Petitioners.

Dated: May 15, 1945.

APPENDIX

STATUTES INVOLVED

The applicable statutes are the Revenue Act of 1936, 49 Stat. 1648, the Revenue Act of 1938, 52 Stat. 447 and the Internal Revenue Code. The pertinent provisions of the Revenue Act of 1936 are as follows:

> "SEC. 22. GROSS INCOME.
>
> "(a) General Definition.—'Gross income' includes gains, profits, and income derived * * * from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, *growing out of the ownership or use of or interest in such property;* also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *" (Our italics.) (49 Stat. 1657.)[1]
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> * * * * *
>
> "Supplement E—Estates and Trusts
>
> "SEC. 161. IMPOSITION OF TAX.
>
> "(a) Application of Tax. The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—
>
> * * * * *
>
> "(b) Computation and Payment.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor.) * * *" (49 Stat. 1706.)[2]
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> * * * * *

"SEC. 166. REVOCABLE TRUSTS.

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) "in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) "in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

"SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

"(a) Where any part of the income of a trust—

"(1) is, or in the discretion of the grantor or any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

"(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

"(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor * * *

then such part of the income of the trust shall be included in computing the net income of the grantor.

"(b) As used in this section, the term 'in the discretion of the grantor' means 'in the discretion of the grantor, either alone or in conjunction with

any person not having a substantial adverse interest in the disposition of the part of the income in question.' " (49 Stat. 1707-1708.)[3]

"SEC. 167 (c). Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor. (Sec. 167(c) was added by Sec. 134(a) of the Revenue Act of 1943.)

"SEC. 181. I.R.C. PARTNERSHIP NOT TAXABLE.

"Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

"SEC. 182. I.R.C. TAX OF PARTNERS.

"In computing the net income of each partner, he shall include, whether or not distribution is made to him—

"(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

"(b) As part of his gains and losses from sales or exchanges of capital assets held for more than

6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

"(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b)."

"SEC. 183. I. R. C. COMPUTATION OF PARTNERSHIP INCOME.

"(a) General Rule.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c) and (d)." Exceptions not material here.)

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[1]Rev. Act 1938, P. 22 (a), 52 Stat. 457, and I. R. C., P. 22 (a), are identical.

[2]Rev. Act 1938, P. 161 (a), (b), 52 Stat. 517, is identical and I. R. C., P. 161 (a), (b), is identical in all material respects.

[3]Rev. Act 1938, PP. 166 (1), (2); 167 (a) (1), (2), (3), (b), 52 Stat. 519, and I. R. C., PP. 166 (1), (2); 167 (a) (1), (2), (3), (b), are identical.

INDEX

CITATIONS

651103—45——1

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 94

LOUIS HAMBURGER AND SAMUEL HAMBURGER, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 95) is not officially reported. The *per curiam* opinion of the circuit court of appeals is reported at 147 F. 2d 856 (R. 121).

JURISDICTION

The judgment of the circuit court of appeals was entered on March 12, 1945 (R. 121). Petition for a writ of certiorari was filed on May 28, 1945. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the courts below have properly held that the taxpayers are taxable upon the income from certain trusts for the years 1937, 1938, 1939, and 1940 under Section 22 (a) of the Revenue Act of 1936 and the doctrine of *Helvering* v. *Clifford,* 309 U. S. 331.

STATUTES INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Section 22 (a) of the Revenue Act of 1938, c. 289, 52 Stat. 447, applicable to the year 1938, and Section 22 (a) of the Internal Revenue Code (26 U. S. C., Sec. 22 (a)), applicable to the years 1939 and 1940, are substantially the same.

STATEMENT

The taxpayers are brothers who became partners in the waste material business about 1926. Sometime prior to December 27, 1937, the business was transferred to H. B. Hamburger & Company and each brother received one-half of the capital stock of that corporation. Louis Hamburger became president of the corporation and Samuel Hamburger became its secretary-treasurer. They continued to operate the business as before. (R. 87.)

On December 27, 1937, the brothers created the trusts here involved. Louis created five separate trusts, one each for his wife and four minor children (R. 87–88). Samuel created two separate trusts, one for his wife and one for his minor child. (Samuel subsequently created another trust for his newly born daughter, having reserved the right so to do in the declaration of trust.) (R. 88.) Each brother transferred all his capital stock in the corporation to his particular family trusts. The provisions of all the trusts were alike except for the names of the beneficiaries and the number of shares transferred. Each trust created by Louis named Samuel as trustee and each trust created by Samuel named Louis as trustee. Each trust was signed by both brothers in their capacities as settlors and trustees. (R. 88, 107.)

Each trust instrument contains the following provisions (R. 88–90):

1. Said Trustee shall have full and complete legal title to said stock, with full right to sell, exchange, mortgage, assign, encumber or otherwise dispose of the same, to the same extent that he could do if said Trustee was the full, legal and equitable owner thereof, and shall have full power to invest the proceeds of the sale thereof or dispose of any other property received in exchange therefor in any manner said Trustee sees fit, without any limitation or restriction whatsoever; said Trustee shall not be limited to making investments such as trustees are ordinarily limited to under the laws of the State of Michigan; that the powers of said Trustee shall include (without limiting the general powers above enumerated) the right to accept a proportionate share of the physical assets upon liquidation of H. B. Hamburger & Company, to use said assets in business either by himself or by entering into a partnership or association with others, to sell the same upon credit, to invest the proceeds thereof in notes of individuals or corporations, to loan money to individuals or corporations, to invest the income or the proceeds of the trust property in stocks, bonds, or any other securities of any nature or description in the sole discretion of said Trustee; that all of said powers shall apply equally to any other property coming into the hands of the Trustee by reason of being exchanged by said Trustee for the original trust property, and all of said powers

granted by this trust instrument to said Trustee shall apply equally to the principal of the trust property, any income therefrom, or any other property which may come into the possession of said Trustee under the powers given to said Trustee hereunder.

2. * * * that said Trustee shall have uncontrolled discretion in connection with the management, care, control and disposition of the said trust property, including any other property which comes into the control of the Trustee under the powers herein granted to said Trustee.

3. That the said Trustee shall, during the lifetime of Settlor, pay the net income to Settlor's wife [child], beneficiary hereunder, or other beneficiary named pursuant to and within the limitations hereinafter contained, or, instead of paying said net income in such manner may, in the sole discretion of said Trustee, accumulate such net income, which accumulations of income shall become part of the trust property, but said accumulations of income, less any net losses sustained prior to distribution, may be distributed by the Trustee in his sole discretion subsequently and prior to the termination of this trust to the then beneficiary or beneficiaries at the time such distribution is made. * * *

It is then provided that after the death of the settlor and until the termination of the trust certain minimum monthly payments shall be made to the beneficiaries (R. 90–91).

It is further provided (R. 91–93):

4. * * * None of the moneys paid to said beneficiaries by the said Trustee shall be used for the support and maintenance of such beneficiary if the then beneficiary at the time of such payment is a child or wife of the Settlor and at that time the Settlor has any obligation to support or maintain said wife or child, or any other person for whom Settlor has any obligation of support or maintenance.

* * * * *

9. That the Settlor hereby expressly reserves the right from time to time during his lifetime, subject, however, to the limitations herein contained, by instrument in writing executed by Settlor and delivered to the Trustee or by appropriate provision in Settlor's last Will and Testament, to change the beneficiary or beneficiaries under this trust, to add a beneficiary, or to increase or decrease the beneficial interest of any beneficiary hereunder, including the right to name a charitable organization as a beneficiary or one of the beneficiaries hereunder; such right to change the beneficiary or beneficiaries may be waived and renounced at any time by the Settlor during his lifetime by written instrument executed by said Settlor and delivered to said trustee; provided, however, that the power reserved herein to change the beneficiary or beneficiaries is hereby expressly limited in that the Settlor shall have no power to

name himself or his estate as beneficiary hereunder.

10. That the Settlor or his estate shall not directly or indirectly become vested or revested with any legal or beneficial interest in the trust property or its proceeds, either of income or principal, nor shall any income, principal, or interest, beneficial or legal, in the trust property be held or accumulated for future distribution to the Settlor or to his estate, nor shall the same be distributed to Settlor or to his estate, nor shall any part of the principal, income, or proceeds of the trust property, or any part thereof, ever be applied to the payment of premiums upon policies of insurance upon the life of the Settlor, nor be used or applied for the support of the Settlor or for the benefit of Settlor or his estate, nor used to satisfy any obligation of the Settlor or his estate.

* * * * *

12. This trust shall continue until the death of the survivor of Louis Hamburger and Samuel Hamburger, and upon the death of the survivor of Louis Hamburger and Samuel Hamburger said trust shall immediately terminate and thereupon both the legal and the equitable title to the trust property, including undistributed accumulations, principal and income and any other property in said trust estate, shall immediately vest in the person or persons who at that time are beneficiary or bene-

ficiaries under this trust, and if more than one person are at that time beneficiary, each shall take an undivided interest therein according to the respective shares which they held as such beneficiaries, and the Trustee or his successor, and all other persons claiming by, through, or under them, shall immediately confirm said title by transferring, assigning and paying over to such beneficiary all of the property, as above described in said trust estate.

* * * * *

14. This trust is hereby declared to be irrevocable and there shall be no power to terminate, alter, or amend this trust instrument, nor shall there be any power on the part of anyone to revest in the Settlor or his estate any part of the corpus of the trust.

After the transfer of the shares to the trusts the remaining assets of each taxpayer consisted of a home, owned jointly with his wife, and life insurance policies amounting to some forty thousand dollars, which was not paid-up insurance. Neither taxpayer had any source of income other than the above-mentioned business. (R. 93.)

As contemplated at the time of the creation of the trusts, the taxpayers individually and as trustees made an agreement, dated December 27, 1938, to carry on the business as partners from and after December 30, 1938, under the firm names of H. B. Hamburger & Company and Production Steel Company, the partnership capital to

consist of all the property of the corporation. The assets were to be transferred by the corporation to the taxpayers, as trustees, pursuant to a plan of liquidation dated December 27, 1938. Louis' trusts were each to receive a 10 percent interest and Samuel's trusts each a $16\frac{2}{3}$ percent interest in the assets. (R. 93–94.) Under the partnership agreement the taxpayers, as trustees, agreed to transfer to the partnership all the assets received from the corporation (R. 94)—

> Provided, however, that so much of said property that consists of real estate or an interest in real estate may be retained in the name of Louis Hamburger and Samuel Hamburger individually but who shall hold the same in trust for the partnership under the terms hereof, this being done merely as a matter of convenience in order to avoid the creation of a cloud upon the title to such real estate and so as to keep the record title to said real estate marketable and to facilitate any future transfer that may be made for the purposes of partnership, the said first and second parties however hereby expressly agreeing that they will not make any transfers of said real estate or any interest therein, nor encumber the same in any way except for the purposes of the partnership and further acknowledge that they are holding said real estate and interest therein as trustees for the use and benefit of said partnership.

The partnership was to be actively managed by the taxpayers, and they were to receive no compensation other than 15 percent each of the profits. Each of Louis' trusts was entitled to seven percent of the profits and each of Samuel's trusts to 11⅔ percent. In the event of the liquidation of the partnership, the taxpayers were to have no right to participate in the distribution of capital except to the extent of their "share of profits and capital increase over and above the fair valuation of the capital at the time of the formation of the partnership over and above all liabilities, and only" to the extent of 15 percent each. The taxpayers agreed to give "the utmost of their skill and power" to the partnership and not to "carry on or be concerned or interested, directly or indirectly, in any other trade or business without the consent in writing of the other parties" to the partnership agreement. (R. 94–95.)

After the dissolution of the corporation, the business was conducted by the taxpayers as theretofore (R. 95).

Each trust had a separate bank account. Some of the partnership profits were paid to the trusts, as determined by the taxpayers. None of the income of any of the trusts was ever distributed to any of the beneficiaries. Samuel at times borrowed money from "the trusts," some of which he had repaid, but he now owes "the trusts" about $15,000 to $18,000. (R. 95.)

The corporation's earned surplus as of December 31, 1938, was $103,522.17 (R. 95).

Each taxpayer filed his 1937 income tax return on March 15, 1938, in which the only income reported by each was $17,500, salary received from H. B. Hamburger & Company. The $14,532.50 dividends received by Louis' five trusts and the $14,532.50 dividends received by Samuel's two trusts were omitted from gross income. Notice of deficiency in each return was mailed on May 25, 1942 (R. 95).

The Commissioner included in the taxpayers' individual income the income of the trusts established by them and assessed the following deficiencies (R. 87):

	1937	1938	1939	1940
Louis Hamburger____	$2, 526. 70	$14, 597. 91	$6, 919. 84	$12, 581. 70
Samuel Hamburger__	2, 591. 80	15, 014. 13	7, 068. 85	12, 941. 00

By stipulation the cases were consolidated for hearing and decision (R. 47–48, 105). The deficiencies were sustained by the Tax Court (R. 99) and the Circuit Court of Appeals for the Sixth Circuit affirmed (R. 121).

ARGUMENT

This case presents but another example of the use of the trust device for reallocation of income among the members of a family group. This Court has clearly enunciated the principles applicable in determining whether in such a situation a taxpayer's control over the trust property is the equivalent of ownership for tax purposes,

and whether the trust income is therefore taxable to him under Section 22 (a) of the Revenue Acts of 1936 and 1938, *supra*. *Helvering* v. *Clifford,* 309 U. S. 331; cf. *Harrison* v. *Schaffner,* 312 U. S. 579; *Helvering* v. *Horst,* 311 U. S. 112. This case is well within those principles, as the Tax Court and the circuit court of appeals both properly held.

1. The taxpayers seek to avoid the impact of the *Clifford* case by an assertion (Pet. 26) that the application of the decision rests on the presence of three essential factors, namely, a short term trust, reversion to the grantor, and retention of control over the trust properties. Here, taxpayers argue, the term of the trusts is not short, as in the *Clifford* case, but for "the longest period for which, under the applicable Michigan Statutes * * *, real property can be retained in trust" (Pet. 19); there is no reversion to the grantors and no power to provide by amendment for reversion (Pet. 20); and the powers of control are dissipated by the fact that the trustees are other than the grantors themselves, and exercise only "powers in trust" (Pet. 21).

We submit that the taxpayers' proposed rationale of the *Clifford* decision represents the very attitude rejected by this Court in that case when it declined "to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no

significance in such household arrangements" (309 U. S. at 336–337). Taxpayers' mechanical analysis of the decision would disregard the Court's broad adjuration that "no one fact is normally decisive but that all considerations and circumstances of the kind we have mentioned are relevant to the question of ownership and are appropriate foundations for findings on that issue" (309 U. S. at 336).

The facts as established by the evidence and found by the Tax Court present no significant difference from those involved in the *Clifford* case. True, they vary therefrom in "the legal paraphernalia which inventive genius may construct as a refuge from surtaxes"; but this, as the Court admonished in the *Clifford* case, "should not obscure the basic issue" (309 U. S. at 334). The grantor is not the trustee; instead, the equal co-owners of a business each placed his half interest in trust for his own family, making the other trustee. After the creation of the trust, therefore, just as before, each controlled one-half of the business. Their powers were, as taxpayers point out, powers in trust; but this was no less so in the *Clifford* case. Moreover, as grantor, each retained decisive power over the distribution of the income from the trusts which he had created. Through his right at any time during his life or by will to change or add to the beneficiaries, and to vary the shares of existing beneficiaries, each retained substantially unalloyed power to channel

the proceeds of his own labors to such members of his family as he might choose—or, if he should choose, to outsiders. Each in his capacity as reciprocal trustee for the other's family had unleavened discretion to control the flow of income to the existing beneficiaries, even to the extent of withholding income altogether. Though neither could revest the property in himself or his estate, each nevertheless retained access to the property for his own personal needs, as is shown by the unrepaid borrowings of taxpayer Samuel Hamburger (R. 95). To quote again the language of the *Clifford* case (p. 335), "where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive as far as § 22 (a) is concerned." Here, the device selected is reciprocal trusteeships, arranged between brothers with identical and complementary business interests and similar familial aspirations. This device adds no more than complexity to the situation; it is totally ineffectual, we submit, to vitiate the conclusion of the trier of fact and of the circuit court of appeals that the trusts were nothing but a tax-saving device (R. 96, 121), and that the brothers remained the owners of the corpus for the purposes of Section 22 (a).

On principle, therefore, we believe that the decision below represents a proper application of the touchstone provided by the *Clifford* case. Nor is there any such conflict as the taxpayers seek to advance in support of their petition. Doubtless there is some lack of uniformity in the methods of statement employed by the various circuit courts of appeals in considering individual cases; and doubtless trusts bearing some of the features here presented have on occasion been held to fall outside Section 22 (a) for lack of other important features not found in the particular case. Such diversity is only natural in an area where the problem of the courts in each instance is to determine whether a particular factual pattern falls on one side or the other of a line, and where the variety of factual patterns, often enough constructed with an eye to tax avoidance, is virtually unlimited. But on the propositions urged by the taxpayers as basic in the application of the principles of the *Clifford* case, there is no conflict. Thus, no case is advanced in support of the proposition that the *Clifford* doctrine is limited to short-term trusts; and in fact the contrary has been held in numerous cases. *Helvering* v. *Stuart,* 317 U. S. 154; *Weil's Estate* v. *Commissioner,* 145 F. 2d 240 (C. C. A. 6), certiorari denied, 323 U. S. 793; *Commissioner* v. *Brown,* 122 F. 2d 800 (C. C. A. 3); *Brown* v. *Commissioner* (the same case at a later stage),

131 F. 2d 640 (C. C. A. 3), certiorari denied, 318 U. S. 767; *Commissioner* v. *Buck,* 120 F. 2d 775 (C. C. A. 2);[1] *White* v. *Higgins,* 116 F. 2d 312 (C. C. A. 1); *Foerderer* v. *Commissioner,* 141 F. 2d 53 (C. C. A. 3); *Williamson* v. *Commissioner,* 132 F 2d 489 (C. C. A. 7). No case is advanced as holding that a power to change beneficiaries at will must be disregarded as a factor merely because unexercised;[2] to the contrary, the significance of such a reserved power, even though unexercised, has been recognized in numerous instances. *Downie* v. *Commissioner,* 133 F. 2d 899 (C. C. A. 6); *Commissioner* v. *Brown, supra; Commissioner* v. *Buck, supra; Hyman* v. *Nunan,* 143 F. 2d 425 (C. C. A. 2). The cases of *Armstrong* v. *Commissioner,* 143 F. 2d 700 (C. C. A. 10), *Commissioner* v. *Branch,* 114 F. 2d 985 (C. C. A. 1), and *Commissioner* v. *Betts,*

[1] Whether or not, as taxpayers suggest (Pet. 27), this case "has been somewhat curtailed by a later decision in the same circuit"—*Phipps* v. *Commissioner*, 137 F. 2d 141 (C. C. A. 2)—we detect therein no recession which would be relevant here. The decision that the corpus in a long-term trust no longer belonged to the grantor for income tax purposes was rested on the fact that the allocation of the income among members of his family could not be controlled by the husband without a disregard of the purposes of the trust sufficiently flagrant in character to violate state law and to call for judicial correction.

[2] *Helvering* v. *Safe Deposit Co.*, 316 U. S. 56, cited at Pet. 11, 27, holding that property held merely subject to an unexercised general testamentary power of appointment is not includible in a decedent's estate under Section 302 (a) of the Revenue Act of 1926, is obviously irrelevant.

123 F. 2d 534 (C. C. A. 7), upon which taxpayers particularly rely (Pet. 9–10) for their claimed conflict, represent no cleavage of principle. In no one of them was the factual pattern significantly similar to that in the case at bar; in none was there so little change in the grantors' family economic situation, such continued dominion and control of the business constituting the trust assets. In none did the grantor retain the right to change the beneficiaries or to borrow freely from the trust funds. These cases do no more than illustrate the differing results which may be reached in applying the *Clifford* doctrine to differing states of fact. They furnish no occasion for the issuance of a writ of certiorari.

2. Taxpayers' references to the provisions of the Internal Revenue Code dealing with partnership income, and to cases decided under these provisions (Pet. 8–9, 31–34), are entirely beside the point.[3] This is not a situation "where the existence of a partnership has been ignored for tax purposes" (Pet. 31). The statutes and authorities relied on may be relevant to the division of partnership income between the individual taxpayers and the trusts; but no such question is involved here. This case deals only with the proper treatment of the income after, and to the

[3] If relevant at all, these provisions and cases would affect the result only for the years 1939 and 1940, since prior to these years the business was carried on in corporate form.

extent that, it has by recognized principles become income of the trusts. The inquiry is whether the taxpayers, not as business partners but as grantors and dominants of the trusts, are to be regarded as owners of the trust property for tax purposes. That question is, we believe, disposed of under the preceding point of this brief.

3. Taxpayers advance as an independent ground for certiorari the contention that the court below is in conflict with other circuits as to the effect of *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, in cases involving application of the *Clifford* doctrine. We see no merit in this contention. It is not clear from the per curiam opinion of the court below whether that court regarded the question as one of law, on which it agreed with the Tax Court, or as one of fact, on which the Tax Court's decision was conclusive because supported by substantial evidence; but in either view the result below was correct. Substantial evidence sustained the Tax Court's findings, and it applied the correct principles of law. Its decision was properly affirmed. *Trust u/w of Bingham* v. *Commissioner,* No. 932, last Term, decided June 4, 1945. Cf. *Weil's Estate v. Commissioner,* 145 F. 2d 240 (C. C. A. 6).

CONCLUSION

The decision below was correct and the petition should be denied.

Respectfully submitted.

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